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Subject: Treasuries Fall for Second Week as Economic Gains Fuel Fed View

Yakov

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Treasuries Fall for Second Week as Economic Gains Fuel Fed View

Treasuries fell for a second week as traders bet economic growth is on a sustainable-enough pace to allow the Federal Reserve to reduce bond-buying later this year even after the U.S. added fewer jobs than forecast last month.

U.S. 30-year bond yields reached the highest level in two years as second quarter economic growth exceeded forecasts and a manufacturing index expanded the fastest in two years. Treasuries trimmed the five-day loss yesterday after the jobs report and rallied July 31 when the Fed said growth has been modest and pledged to keep buying $85 billion of bonds a month. Treasury will sell $72 billion of notes and bonds next week.

“The economy continues to expand at a moderate pace, and the Fed still wants to remove accommodation as soon as they can,” said Dan Greenhaus, chief global strategist in New York at broker-dealer BTIG LLC. “The weaker-than-expected jobs numbers isn’t enough to reverse the stronger momentum. We’ll need to see more to slow the tapering story.”

The benchmark U.S. 10-year yield rose three basis points this week, or 0.03 percentage point, to 2.60 percent in New York, Bloomberg Bond Trader data showed. The price of the 1.75 percent note due in May 2023 dropped 1/4, or $2.50 per $1,000 face amount, to 92 23/32. The two-week yield gain was 12 basis points and it touched 2.74 percent yesterday, almost the 2013 high of 2.75 percent reached on July 8.

Thirty-year bond yields added six basis points to 3.68 percent, and touched 3.78 percent, the highest since August 2011.

Yield Difference

The difference between two- and 30-year yields reached 343 basis points, the most since August 2011. A steeper yield curve reflects diminishing demand from investors for longer-maturity bonds on speculation that growth and inflation will accelerate at a faster pace.

Hedge-fund managers and other large speculators shifted to a net-long position in 10-year note futures in the week ending July 30, according to U.S. Commodity Futures Trading Commission data. Speculative long positions, or bets prices will rise, outnumbered short positions by 11,903 contracts on the Chicago Board of Trade. Last week, traders were net-short 32,312 contracts.

The government will sell $32 billion of three-year notes, $24 billion of 10-year notes and $16 billion of 30-year bonds next week, raising $2.4 billion of new cash as investors will redeem $69.6 billion of

securities maturing on Aug. 15.

A measure of demand at U.S. debt auctions has fallen this year to the lowest level since 2009 as a drop in bond prices generates the biggest losses on government securities in four years.

Auction Details

Investors bid $2.91 for each $1 of the $1.257 billion of notes and bonds sold by the Treasury this year, compared with a record high $3.15 of bids last year. It's the first decline in demand at the auctions since 2008, when the U.S. government increased note and bond offerings 59 percent to $922 billion as the recession and the financial crisis deepened.

The Treasury Department also said it plans to sell the first floating-rate notes in January and expects to gradually decrease coupon-auction sizes during the coming quarter as the nation's fiscal health improves.

The Fed is buying $85 billion of bonds each month, known as quantitative easing, to put downward pressure on interest rates, and policy makers are discussing whether the economy has improved enough for them to start reducing the purchases.

"Economic activity expanded at a modest pace during the first half of the year," the Fed said following a two-day meeting of the Federal Open Market Committee July 31. "The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, but it anticipates that inflation will move back toward its objective over the medium term."

Futures Gauge

Fed funds futures show a 43 percent probability that the central bank will raise borrowing costs in January 2015 for the first time after the 2008 financial crisis, down from 49.8 percent the day before.

"The trends to higher rates still persist," said William O'Donnell, head U.S. government bond strategist at Royal Bank of Scotland Group Plc's RBS Securities unit in Stamford, Connecticut, one of 21 primary dealers that trade with the Fed. "The Fed wants to make tracks to ending the program according to their schedule."

The economy has added an average of 192,000 jobs this year through July, the fastest pace since 2005 when it created 207,000 positions per month, Labor Department data show.

Economic Updates

Gross domestic product, the value of all goods and services produced, rose at a 1.7 percent annualized rate, topping a 1 percent forecast, after a 1.1 percent gain the prior quarter that was smaller than previously estimated, Commerce Department figures showed July 31 in Washington. The Institute for Supply Management's manufacturing index increased to 55.4 in July from 50.9 a month earlier, the Tempe, Arizona-based group said. The median forecast of 84 economists surveyed by Bloomberg called for the measure to rise to 52.

"The data has been very impressive, and it's pointing toward growth that will likely allow the Fed to start reducing its asset purchases," said Ira Jersey, an interest-rate strategist at Credit Suisse Group AG in New York, one of 21 primary dealers that are required to bid at Treasury auctions.

Treasuries fell for a third month in July, dropping 3.5 percent since the end of April, based on the Bloomberg U.S. Treasury Bond Index. (BUSY) Investment-grade company debt declined 4.1 percent over the past three months even after gaining in July, the Bloomberg USD Corporate Bond Index (BUSC) shows.

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